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Small businessman and his financial statements

Gerald McFadden Francis

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U. S. DEPARTMENT OF COMMERCE

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UNITED STATES DEPARTMENT OF COMMERCE
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The Small Businessman and His Financial Statements

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FOREWORD

This pamphlet is designed primarily for proprietors of new businesses and for those that classify as small operating units. It aims to provide (1) some background information about accounting and bookkeeping procedures and (2) specific methods of analyzing business accounts and statements for improving management.

The discussion is not meant to be comprehensive. It contains sufficient information and suggestions to enable proprietors to cope with problems of business records and reports. Also, by means of sample forms of statements and a classified set of ledger accounts, as well as by suggestions of additional materials available from the Department of Commerce on the subject of financial and operating statements, it is hoped that many small businessmen may be induced to become better acquainted with effective methods of statement preparation and analysis.

This study was prepared in the Finance and Tax Division, J. M. Rountree, Chief.

CONTENTS

The Small Businessman and His Financial Statements

Although records of some kind are kept in most businesses, their quality and usefulness vary widely with individual concerns. There is increasing recognition by businessmen, however, that under present-day conditions complete accounts and records are essential to efficient operation. This is because proprietors and managers realize their need for financial statements that summarize the results of past operations and contribute essential data for planning and guiding future policy.

There are a number of reasons for keeping records of business transactions, among which are the following:

(1) To meet the requirements of management for essential information in controlling operations.

(2) To satisfy needs of creditors and investors.

(3) To provide information required by governmental agencies in connection with taxation and regulation.

(4) To supply both general and detailed information to trade organizations and the public.

This publication is concerned with the first, and chief, function of business records and statements, namely, to enable management to be more efficient in directing present activities and planning future policies and growth.

ACCOUNTING PROBLEMS OF SMALL BUSINESSES

Many small businessmen fail to realize the importance of complete and accurate records for management purposes. The typical proprietor, especially at the start of his business, has little knowledge of, or familiarity with, financial statements in terms of their accounting requirements, procedures, and principles. He frequently is forced to occupy himself too exclusively with the details of everyday operations and as a result is unable to give sufficient attention to his accounts and statements. Thus he fails to obtain an adequate view of the trends and directions of his business and what to do about them.

Except in the smallest concerns, a proprietor cannot expect to have a detailed knowledge of all accounting operations and records. If he starts his business on a small scale and organizes it carefully with clear and complete records, he may by alertness and energy continue to hold effective control as it grows larger and more complicated. This type of development, however, is the exception. Many concerns start without proper preliminary planning of records essential to effective management. Later, they find their accounting systems fail to show a clear picture of what goes on in the business. At this stage, they may plan to modernize the old system of account so as to provide types of information and statements needed in performance of management duties. Usually this proves to be an expensive operation and one that most concerns are slow to take. As a result, efficiency is lowered and the risk of failure and termination increased.

As a business proprietor you should see that your accountant or bookkeeper has authority and facilities for keeping adequate records and for compiling standard financial statements consisting of a balance sheet and a profit-and-loss statement. You should make further provision for analysis and interpretation of these statements for your use in reviewing past operations and in planning for the future. If your business is one which cannot yet afford the outlay for all of these accounting services, as general manager or proprietor you should equip yourself so as to be able to analyze and make proper management use of your statements.

The personnel problem in the bookkeeping phase of small business is acute in contrast with large enterprises which provide a high degree of specialization in this function and some means of employee training and supervision. The recent large demand for accountants and bookkeepers has attracted many individuals with superior qualifications into larger organizations which pay higher wages and provide more opportunity for advancement. Small businesses of the size in which the proprietor once performed all record-keeping functions are nowadays greatly handicapped, on the one hand, by this shortage of qualified employees and, on the other, by the increased complexity of accounting problems resulting from changing business methods and expanding demands by Federal and State Governments for tax and other accounting reports.

Small-business proprietors need, therefore, to understand more fully the accounting requirements of their businesses and how financial statements are made up and may be used to improve the quality of their management.

RELATION OF FINANCIAL STATEMENTS TO RECORD KEEPING

The basic statement of business condition at a particular time is the balance sheet. The statement of operating results for a period of time is the profit-and-loss statement. These statements are built from data appearing in ledger accounts at the end of a business period. They, along with certain supporting schedules, such as an itemized listing of assets and of accounts and notes receivable, have become standard forms of reporting the results and condition of business enterprises.

If you are familiar only in a general way with the double-entry system of keeping accounts, you may be helped by the following illustrative outline of bookkeeping practices as background data for the preparation of standard business statements.

Systems of bookkeeping and accounting vary greatly among businesses of various industries, trades, and sizes of operation. However, the basic framework of double-entry accounting is usually present in all systems.

The first step in keeping business records is making out original invoices, "tickets," or other records as evidence of sales, purchases, and general transactions. Many new businesses get themselves into needless difficulties by failing to make a clear record of each transaction. In most sizable enterprises, original records frequently are "journalized" by machines and the totals later are transferred to ledger accounts. In smaller concerns, data from original vouchers or invoices of transactions are entered by a bookkeeper in the journal. However, aggregates of sales and other repetitive items are now commonly transferred from cash registers in daily totals and entered directly in the journal.

Accounts are kept in the ledger for each of the asset items, for each form of debt, and for the proprietor's capital. Also, ledger accounts are set up for all of the income and expense groups. Into each of these several accounts are placed debit or credit entries, in accordance with the basic method of double entry accounting. These ledger entries are made by the process of posting journal entries to the various ledger accounts. "Posting" the ledger accounts means transferring journal entries, made daily or at other periodic intervals, into the various ledger accounts affected. Exhibit 1 outlines the complete account classification for a small distributing corporation.

At the end of a period of operation, such as 1 month or 1 year, the ledger accounts are summarized for the purpose of determining the net profit or loss and to show the financial condition of the business. First, a trial balance, which consists of a list of ledger accounts with their respective debit and credit balances, is set up.

Exhibit 1.—*CHART OF ACCOUNTS FOR THE MODERN DISTRIBUTING COMPANY, INC.*

1. Asset accounts.
    - Current assets.
        - Cash.
            - Bank A.
            - Bank B.
            - Petty cash.
        - Notes receivable.
        - Accounts receivable.
        - Reserve for bad debts.
        - Accrued incomes.
            - Accrued interest income.
            - Accrued commission income.
        - Merchandise inventories.
            - Department 1.
            - Department 2.
        - Prepaid expenses.
            - Unexpired insurance.
            - Office supplies on hand.
            - Shipping supplies on hand.
    - Fixed assets.
        - Store furniture and fixtures.
        - Reserve for depreciation of store furniture and fixtures.
        - Office furniture and fixtures.
        - Reserve for depreciation of office furniture and fixtures.
        - Delivery equipment.
        - Reserve for depreciation of delivery equipment.
        - Building.
        - Reserve for depreciation of building.
        - Land.
    - Other assets.
        - Sinking fund for bonds payable.
        - Goodwill.

1. Asset accounts—Continued
   - Other assets—Continued
     - Deferred charges.
       - Organization expenses.
2. Liability accounts.
   - Current liabilities.
     - Notes payable.
     - Accounts payable.
     - Accrued expenses.
       - Accrued wages.
       - Accrued taxes.
       - Accrued interest expense.
     - Prepaid incomes.
       - Prepaid rent income.
       - Prepaid interest income.
   - Fixed liabilities.
     - Bonds payable.
   - Deferred credits.
     - Premium on bonds payable.
3. Vested proprietorship accounts.
   - Capital stock accounts.
     - Capital stock.
   - Surplus accounts.
     - Surplus.
     - Sinking fund reserve.
4. Summary accounts.
   - Cost of goods sold.
   - Profit and loss.
5. Income accounts.
   - Sales.
     - Sales, department 1.
     - Sales, department 2.
   - Sales returns and allowances.
     - Sales returns and allowances, department 1.
     - Sales returns and allowances, department 2.
   - Financial income.
     - Interest income.
     - Purchase discount.
6. Operating expense accounts.
   - Purchases.
     - Purchases, department 1.
     - Purchases, department 2.
     - Freight in.
   - Purchase returns and allowances.
     - Purchase returns and allowances, department 1.
     - Purchase returns and allowances, department 2.
   - Selling expenses.
     - Salesmen's salaries.
     - Salesmen's commission.
     - Advertising.
     - Freight out.
     - Delivery expenses.
     - Shipping supplies.
     - Depreciation expense.
       - Depreciation of store furniture and fixtures.
       - Depreciation of delivery equipment.
   - General expenses.
     - Office salaries.
     - Office supplies.
     - Office expenses.
     - Taxes.
     - Insurance.
     - Depreciation expense.
       - Depreciation of office furniture and fixtures.
       - Depreciation of building.
   - Financial expenses.
     - Interest expense.
     - Bad debts.
     - Sales discount.
     - Collection expense.
7. Nonoperating accounts.
   - Nonoperating expenses.
     - Loss on sale of fixed assets.
   - Nonoperating incomes.
     - Commission income.
     - Rental income.

Source: *Elementary Accounting*, by Newlove, Haynes, and White, D. C. Heath and Company, 1941.

A summarization known as a work sheet is then completed by making necessary adjustments in the account balances listed in the trial balance. These adjustments are made in order to give recognition to heretofore unrecorded portions or amounts of certain assets, liabilities, and income and expense affected or used up by operations of the period.

For example assets, such as buildings, officer equipment, supplies, and delivery equipment, gradually lose some of the value represented by their original cash investment. At each period for determining profit, the bookkeeper or accountant charges to an appropriate expense account, such as office supplies used, the value of supplies actually consumed in the period. A similar procedure applies to depreciation in value of plant, machinery, trucks, and other medium- and long-term assets. After adjustments are completed, entries are made on the work sheet closing the income and expense accounts to the profit and loss account. In this manner, correct figures are determined for preparation of the financial and operating statements.

The process of adjusting and closing accounts is a technical one which can be handled best by a qualified bookkeeper or accountant. In many small businesses, the bookkeeper may not be sufficiently experienced to summarize the accounts, make necessary adjustments, and prepare statements. In such situations, services of a public accountant may be needed.

In order for a proprietor to keep his books in the detail indicated, he should employ a trained and experienced bookkeeper. If this is impossible at the start, he should acquaint himself with the basic processes in keeping and summarizing double-entry accounts. In a new small enterprise, the work of keeping the accounts may be handled by the proprietor for a time if he has some knowledge of bookkeeping. As a business grows, however, it is always more satisfactory and usually necessary to have one person specialize in record keeping. When, as usually occurs, the proprietor becomes largely preoccupied with managerial duties, the routine of bookkeeping may best be assigned to a person who has been trained in that field.

When the accounts have been summarized by means of a work sheet containing the trial balance, adjusting and closing entries, the data are available for preparing the statements. Figures for both balance sheet and profit and loss statement are to be found on a completed work sheet. Since the accounts are listed there without classification, it is at this stage the accountant usually classifies the assets, liabilities, income, and expenses in preparing the statements.

TYPES OF FINANCIAL ANALYSIS

Many small business operators unfortunately fail to see the benefits to themselves in making expenditures for accounting and financial analysis services. A common practice of such concerns for determining their financial condition is to compare cash receipts with disbursements for a period. If a surplus of cash is found to exist, the business is considered in the "black." No attempt may have been made to keep or to examine details of records and operations. Even where operating statements are attempted, many businesses are too easily satisfied with superficial accounting records and statements. Modern business operation and competition require exact knowledge of what takes place and the results of transactions. This is the reason for reliable statements and clear analysis of their meaning.

There are several ways of interpreting the contents of financial statements for management purposes. First, careful definition is essential to understand the meanings and amounts of various items making up the periodic statements. Second, a statement is further clarified by tracing from one fiscal period to another the comparative relationships of its chief items and subdivisions. Third, comparison of certain items with certain other items—a process usually designated as ratio analysis—highlights certain relationships not usually revealed by the first two methods. These three methods of financial analysis are explained and applied in the following sections.

I. Interpreting Annual Financial Statements

Balance sheet analysis.—A standard balance sheet is a statement of all the main items of assets (properties held for use in the business) followed by a listing of the liabilities (debts) and the net worth or proprietor's ownership. The assets are classified and arranged in order of their convertibility into cash, i. e., those that are current, those that are fixed, and other types of assets. The debts of a business represent claims to parts of its assets. The remaining asset values belong to the proprietor or to net worth. These facts explain the meaning of the so-called balance-sheet equation: Assets minus debts equal net worth. (See sample balance sheet, table 1, for the Modern Distributing Co., Inc., a small retail distribution concern dealing in hardware, tools, seed, feeds, etc.)

Current assets include cash, notes and accounts receivable, inventories, prepaid expenses, and readily marketable securities. Current assets always consist of liquid funds, or items normally convertible into cash within one to a few months. Where items which have been carried as current become nonliquid, such as uncollectible receivables and outdated inventory, they should be charged to loss or reclassified into "other" assets.

Fixed assets are made up of physical properties, such as land, buildings, and machinery and equipment, useful in the business and in which funds have been invested for comparatively long term.

Other assets refer to various properties or claims which differ to some extent with various types of businesses and situations. They may consist of special term deposits in banks, accounts receivable that have become doubtful of collection, long-term investments external to business operations, and deferred charges which are a type of long-term prepayment, as for organization expense, that will be absorbed or charged off over a number of business periods.

The nature of a business and its operations determine the extent of its capital investment in current assets as compared with fixed assets. For example, a garage or small factory ordinarily requires a higher proportion of investment in fixed assets, such as plant or machinery and equipment, than does a merchandising concern engaged only in buying and selling, for which nominal amounts of plant and equipment are needed.

Your business should avoid acquiring any fixed assets not essential to efficient operation. This idea is often stated in a different manner by saying that business assets should be kept as liquid or current as possible. A newcomer to a business should determine what the typical fixed asset requirements of other units have been in his new line. This topic is discussed more precisely in a subsequent section on ratio analysis.[1]

Current assets themselves often present serious problems to management. Accounts and notes receivable and inventory need to be carefully controlled so that neither becomes excessive or over aged. For example, if you decide to grant credit to your customers, you should adopt definite standards for credit, as well as uniform terms and procedures for collection. Credit problems vary considerably with alternating periods of rising and falling prices, while inventory difficulties arise from excessive purchasing, changes in consumers' tastes, and technical improvements in products. Such dangers may be frequently detected and avoided by close attention to general business and operating trends. Such trends are presented monthly in the Department of Commerce publication, Survey of Current Business.

In addition to showing asset values, the balance sheet shows the creditors' and proprietor's claims to the assets. These items may be placed below the list of assets, in which case the balance sheet is in "report" form, as in table 1. When liabilities and proprietorship are placed to the right of the asset listing, the balance sheet is in "account" form. There is no distinct preference to either of these two forms though the "report" form is usually more compact in appearance.

Liabilities, or debts, like the assets, are shown listed in the order of their maturity, starting with the one with the shortest maturity. Current liabilities consist of notes payable, accounts payable, and accrued but unpaid expenses. Fixed or longer term liabilities consist of mortgages and notes payable, or other debt, with maturities of 1 year or more. Since assumption of either current or longer term debts results in regular obligations for interest and principal repayments, the types and amounts of debts assumed should be carefully considered in relation to prospective ability to meet such payments.

Table 1.—*MODERN DISTRIBUTING CO., INC.*

BALANCE SHEET DEC. 31, 1946

ASSETS

Current assets:			
Cash		$500	
Notes receivable		1,000	
Accounts receivable	$5,000		
Less: Reserve for depreciation	150		
		4,850	
Inventories		8,000	
Accrued interest income		10	
Prepaid insurance		20	
Investments (marketable)		1,000	
Total current assets			$15,380

[1] The reader is also referred to the series of Inquiry Reference leaflets on the subject of business operating ratios, issued by the U. S. Department of Commerce, Office of Domestic Commerce, Marketing Division. A list of these leaflets appears in the bibliography appended to this study.

Table 1.—*MODERN DISTRIBUTING CO., INC.*—Continued

BALANCE SHEET DEC. 31, 1946—Continued

ASSETS—Continued

Fixed assets:			
Land		$3,000	
Buildings	$12,000		
Less: Reserve for depreciation	4,000		
		8,000	
Machinery and equipment	10,000		
Less: Reserve for depreciation	3,000		
		7,000	
Total fixed assets			$18,000
Other assets:			
Special deposits			400
Noncurrent receivables			900
Deferred charges			450
Total assets			35,130

LIABILITIES AND PROPRIETORSHIP

Current liabilities:			
Notes payable	$2,000		
Accounts payable	3,700		
Accrued salaries payable	300		
Total current liabilities		$6,000	
Fixed liabilities:			
Mortgage payable		8,000	
Short-term notes payable		2,000	
Total liabilities			16,000
Capital stock		10,000	
Surplus		5,000	
Reserves for contingencies		4,130	
Total proprietorship			19,130
Total liabilities and proprietorship			35,130

The amount by which the current assets exceed the amount of current liabilities is the working capital of your business. In the Modern Distributing Co. (table 1) working capital is found by subtracting the total current liabilities ($6,000) from the total current assets ($15,380) leaving a net working capital of $9,380. You should maintain such a margin of free or working current assets above the amount necessary to meet emergency payments of current debts. The specific amount required depends upon the individual business and its probable needs for expansion or to take advantage of purchase opportunities. A common rule is that working capital should at least equal current liabilities. In other words the current assets should be double the amount of current liabilities. The Modern Distributing

Co.'s ratio of current assets to current liabilities may be shown thus: $\frac{\$15{,}380 \text{ C. A.}}{\$6{,}000 \text{ C. L.}}$ or \$2.56. While so high a current ratio may not need to be maintained in all situations, every small businessman should give close attention to the working capital position of his concern in order to avoid a situation where all current assets will be used up in meeting unexpected maturities of current liabilities.

In an incorporated business, the proprietorship, that is, ownership by stockholders, usually consists of capital stock and surplus, plus any special reserves. Capital stock is that portion of the proprietorship represented by share held by stockholders. Surplus is the amount of ownership which has not been assigned to specific shareholders through issuance of stock certificates nor reserved to specific purposes by action of a board of directors or trustees. For this reason the "general" surplus is sometimes refered to as "free" surplus because it has not been "reserved" to a specific use in the business.

There are two types of reserves commonly shown on the balance sheet. These are valuation reserves and proprietorship reserves. The latter consist of amounts of net profit or of net worth which have been set aside for special contingencies, such as possible loss through inventory price declines and the chance of rapid technical changes in plant machinery and equipment with consequent heavy cost in replacing present equipment. These "special" proprietorship reserves, therefore, simply designate a portion of the net worth or ownership that may be used for a specified purpose at some future time.

Valuation reserves represent a part of ownership accumulated from past earnings and set up in a special account to absorb losses normally to be expected in the process of operation. In contrast with "special" reserves, valuation reserves are more certain of application to their designated use since they are designed to replace asset values normally used up in operation. Examples are depreciation reserves to offset wear and tear on physical property, and reserves to replace uncollectible accounts receivable. On the sample balance sheet (table 1) these valuation reserves are shown on the asset portion as deductions from asset items. Such reserves may be, and frequently are, placed in the net worth section of the balance sheet. In this event, the assets to which reserves apply are carried at their original cost.

The above analysis of proprietorship applies generally to unincorporated businesses except for the items capital stock and surplus. A single proprietor lists his capital in one figure which denotes his net asset ownership after making allowance out of total assets for payment of all debts. For example, if the business represented in table 1 were a single enterprise instead of a corporation, its proprietorship item might be written John Doe, capital \$19,130.

The single enterprise business ordinarily needs to accumulate annually out of earnings both valuation reserves on physical assets and proprietorship reserves for special risks. These reserves usually are increased by addition from each year's profits in order to bring the total reserve up to the estimated loss or risk. After giving effect to these deductions and to any personal withdrawal made by the proprietor, the net profit of an unincorporated business is added to proprietor's capital.

Analysis of profit and loss statement.—The statement of profit and loss is a summary of operating condition for the period indicated in its heading. This statement shows the volume and types of business done in the period, the total income received and expenses paid, and sets forth the profit or loss and how this result was obtained. Table 2 shows a sample profit and loss statement for the Modern Distributing Co., Inc., for the year ending December 31, 1946.

Table 2.—*MODERN DISTRIBUTING COMPANY, INC.*

STATEMENT OF PROFIT AND LOSS FOR YEAR ENDED DEC. 31, 1946

Gross sales			$50,000
Less sales returns and allowances			800
Net sales			49,200
Cost of goods sold:			
Opening inventory	$10,000		
Purchases	32,000		
Freight-in	600		
		$42,600	
Less:			
Purchase return allowances	500		
Closing inventory	8,000		
		8,500	
Cost of goods sold			34,100
Gross profit			15,100
Operating expenses:			
Selling expenses:			
Salesmen's salaries	$3,500		
Advertising	50		
Delivery expenses	650		
Depreciation of store equipment	300		
		$4,500	
General and administrative expenses:			
Rent expense	1,200		
Heat, light, and power	125		
Office salaries	3,500		
Insurance expense	150		
Depreciation of building	500		
		5,475	
Financial expenses:			
Interest expense	40		
Bad debts	100		
		140	
			10,115
Net operating profit			4,985

Table 2.—*MODERN DISTRIBUTING COMPANY, INC.*—Continued

STATEMENT OF PROFIT AND LOSS FOR YEAR ENDED DEC. 31, 1946—Continued

Nonoperating income: Interest income	$25	
Nonoperating expense: Loss on sale of fixed assets	200	
		$175
Net profit for period		4,810

In the ordinary trading or merchandising concern there are four principal functions performed. These are: (1) buying; (2) selling; (3) financing; and (4) administration. In an industrial concern, additional functions are determined by the number and types of manufacturing operations carried on.

Gross income derived from sales of merchandise, from rendering services, or from manufacturing or processing goods prior to the distribution stage, is shown first on the profit-and-loss statement. In a merchandising concern the gross sales ordinarily represent total receipts and are usually subject to some reduction by the amount of sales returns and allowances. The resulting figure is called net sales. (See table 2.)

The principal type of outlay or cost in a trading business is for purchase of goods to be sold. This figure covers not only the invoice cost of merchandise purchased, but also the freight and delivery charges thereon. The difference between the total costs of merchandise sold during the period and the receipts from the sales of merchandise in the same period is the gross profit. Gross profit is not the final profit or income available to a business proprietor. From gross profit must be deducted all business operating expenses. These are ordinarily grouped into (1) selling expenses, (2) general or administrative expenses, and (3) financing expenses.

Selling expenses normally include salesmen's salaries, advertising and delivery outlays, and any other expenditures incidental to the selling function, such as maintenance and depreciation on store and delivery equipment and on other facilities used in selling operations.

General or administrative expenses include rent, office salaries, expenditures for utility services and insurance, and the depreciation and maintenance of the general business properties, such as buildings, equipment, and facilities.

Financial expenses may include outlays incurred in securing and using loans and other capital funds, in authorizing and extending credit to customers, and in paying for losses resulting from such operations.

Total expenses of the business are deducted from its gross profit derived from sales and from any other operating transactions. If the proprietor in making sales has established a sufficient profit mark-up over the cost of the goods, his gross margin should be sufficient to cover all business expenses and leave a net operating profit to the business.

Table 2 summarizes the general features of profit and loss. Beginning with gross sales it shows in order the net sales, cost of goods sold, and the gross profit. Following gross profit is an itemized statement of expenses under the heading "selling," "general and administrative," and "financial expenses." The deduction of total expenses results in net operating profit (or loss).

Income and expenses of a nonoperating character frequently are met in businesses. All income and expense not arising out of regular operations of the business should be classed as nonoperating. For example, table 2 shows nonoperating income in the form of interest income on investments and nonoperating expenses in the form of loss on the sale of fixed assets. After giving effect to these items the net or final income for the period results. Refer to the outline of standard ledger accounts and their classification in exhibit 1, p. 3, for typical account titles.

One of the principal purposes of the statement of profit and loss is to fix responsibility for the operating results shown by it. This is frequently accomplished by classification in the statement or in subsidiary exhibits. For example, as shown in table 3, the sales may be broken down by commodity groups in order that the trends of sales volume can be traced from period to period. Likewise, the cost of goods or materials purchased for sale by the business may be classified into main groups with allocation of expenses by departments, so as to permit some analysis of departmental gross and net operating efficiencies.

II. Interpretation by Comparing Current Statements With Statements of Previous Years

Analysis by means of comparative balance sheets.—In addition to understanding the general form of the balance sheet for a specific year and the significance of the items on it, a proprietor should recognize the advantages of comparing his latest balance-sheet figures with those of one or more previous dates. This practice enables him to see the amount and direction of changes in items on the statement and thus to interpret the results of his latest operations upon his financial condition.

The increase or decrease of a balance-sheet item from one period to the next, however, is more informative in most cases if it is stated in terms of the percentage increase or decrease instead of the change in number of dollars. For example, a statement that total assets increased $100,000 between 1945 and 1946 provides certain information, but the statement that the increase in total assets was 10 percent has more meaning to the businessman. For this reason, a comparative balance sheet (see table 4) should show the asset, liability, and proprietorship figures as of two or more dates ending successive fiscal periods and should, in addition, show the percentage change in each of the items. As a business proprietor, your primary interest is in the amount of the item on the latest report and the percentage change from the last previous statement.

Table 3.—*MODERN DISTRIBUTING CO., INC.*

ITEMIZED STATEMENT OF DEPARTMENTAL OPERATIONS FISCAL YEAR ENDING DEC. 31, 1946

	Hardware tools and metal products	Seeds, feeds and nursery stock	Insecticides, chemicals and biologicals	Fertilizers, plant foods, etc.	Miscellaneous and general	Total
Sales (net)	$18,000	$12,000	$10,000	$7,000	$2,200	$49,200
Cost of goods sold	12,100	8,000	6,000	6,000	2,000	34,100
Gross profits	5,900	4,000	4,000	1,000	200	15,100
Expenses:						
Selling	1,500	1,300	1,100	500	100	4,500
Administrative and general	2,000	1,500	1,675	300	....	5,475
Financing	100	....	....	40	....	140
Total expenses	3,600	2,800	2,775	840	100	10,115
Net operating profit	2,300	1,200	1,225	160	100	4,985

Table 4.—*MODERN DISTRIBUTING CO., INC.*

CONDENSED COMPARATIVE BALANCE SHEET DEC. 31, 1945 AND 1946

	1946	1945	Percentage increase or decrease *	Percent of total	
				1946	1945
Assets					
Current assets	$15, 380	$12, 200	26. 0	43. 8	43. 0
Fixed assets	18, 000	14, 100	27. 6	51. 2	49. 6
Other assets	1, 750	2, 100	* 16. 6	5. 0	7. 4
Total assets	35, 130	28, 400	23. 7	100. 0	100. 0
Liabilities and net worth					
Current liabilities	6, 000	4, 000	50. 0	17. 1	14. 0
Fixed liabilities	10, 000	8, 000	25. 0	28. 5	28. 1
Capital stock	10, 000	10, 000	00. 0	28. 5	35. 2
Surplus	5, 000	4, 000	25. 0	14. 2	14. 0
Reserves for contingencies	4, 130	2, 400	72. 1	11. 7	8. 7
Total	35, 130	28, 400	23. 7	100. 0	100. 0
Working capital	9, 380	8, 200	11. 4	....	....

A comparative balance sheet also shows the percentage distribution of the total assets among the various individual assets, and percentage distribution of the total liabilities and net worth among the several items in those categories. Such percentage distribution figures for two or more dates enable a proprietor to analyze his statement more readily for purposes of determining the nature of changes in financial status. For example, it will reveal whether current assets have grown or decreased in proportion to total assets over several years in comparison with similar proportionate changes in current liabilities. Table 4 presents a comparative balance sheet for the Modern Distributing Co. for 2 years only. It is important to realize that comparison of 3 or 4, or even more, years may be made depending upon the needs of the proprietor at a specific time.

Analysis by means of comparative profit and loss statements.—The comparative profit and loss statement, like the comparative balance sheet, presents data for several consecutive years in parallel columns and shows the changes among items from year to year. Usually in such a statement data for the latest fiscal period are shown in the first money column to the left with data for the preceding period or periods in the next columns to the right. Also comparative statements may be presented in condensed form as shown in table 5, since it is the main items that usually are desired for comparative purposes.

Table 5.—*MODERN DISTRIBUTING CO., INC.*

CONDENSED COMPARATIVE STATEMENT OF OPERATING PROFIT AND LOSS FOR YEARS ENDED DEC. 31, 1946 AND 1945

	1946	1945	Percentage increase or decrease	Percent of total	
				1946	1945
Gross sales	$50,000	$40,000	25.0	102.0	102.0
Less: Returns and allowances	800	700	14.1	2.0	2.0
Net sales	49,200	39,300	25.0	100.0	100.0
Cost of goods sold	34,100	28,300	21.0	69.3	72.0
Gross profit	15,100	11,000	37.0	30.7	28.0
Operating expenses:					
Selling	4,500	3,200	41.0	9.1	8.1
Administrative and general	5,474	3,400	61.0	11.1	8.6
Financial	140	100	40.0	.3	.3
Total expenses	10,115	6,700	51.0	20.5	17.0
Net operating profit	4,985	4,300	16.0	10.2	11.0

As in the case of balance sheets, a useful device on comparative profit and loss statements is inclusion of percentage figures showing growth or decline in the various items making up the statement. These figures enable the manager or proprietor to comprehend readily the trend of the sales, cost of goods, and expenses from one period to another. A comparative profit and loss statement also should show a percentage distribution based on net sales as 100 percent. Such percentage figures likewise enable the manager to note the proportion or number of cents from each dollar of sales that go for goods purchased, for various expenses, and the amount remaining as operating income. Percentage figures of operating data are of great value in checking efficiency trends of a concern.

Each proprietor ordinarily prefers to determine for himself the amount of detail which he desires to be placed in the comparative profit and loss statement and the number of years for which data are wanted. In the ordinary situation, it is not especially useful to carry your comparison of current data further back than the two previous fiscal periods. An exception to this might be where a bank or credit rating agency is examining the growth of your concern for purpose of granting a loan or establishing a credit rating.

III. Interpretation by Means of Financial and Operating Ratios

Analysis by means of ratios.—In addition to inspecting current financial and operating statements for a specific period and also noting changes taking place in them from period to period, there is another useful source of information for business proprietors in a method known as ratio analysis. This process involves comparing one item with another on the balance sheet or on the operating statement, or comparing items selected from the two statements. Where two items from the balance sheet or financial statement are compared, the resulting figure is called a financial ratio. For example, the current ratio, that is $\frac{\text{current assets}}{\text{current liabilities}}$, is a financial ratio. When a ratio uses one item drawn from the operating statement it is called an operating ratio since it relates to some phase of the current operations. An example is the inventory turnover ratio, $\frac{\text{net sales}}{\text{merchandise inventory}}$.

It is possible to compute a large number of ratios. In fact, attempts at ratio analysis frequently have led to use of an excessive number of ratios with the result of confusion rather than clarity.

The following financial and operating ratios are suggested as worth the attention of businessmen. As manager or proprietor you may use one or more of these ratios in accordance with your own needs and preferences.

Financial ratios:

1. Current assets to current liabilities (current ratio).
2. Quick assets (cash and receivables) to current liabilities (acid test ratio).
3. Inventory to current assets.
4. Liabilities to net worth.
5. Surplus to net worth.
6. Net worth to fixed assets.

Operating ratios:

7. Net sales to inventory (merchandise turn-over).
8. Net sales to receivables.
9. Net sales to net worth.
10. Net profit to net worth.
11. Net profit to total assets.
12. Net profit to net sales.

In presenting the characteristics of these ratios, figures from the statements of the Modern Distributing Co. have been used for the fiscal years ended December 31, 1941–46, inclusive. It should be remembered that ratios are to be used as a part of the over-all analysis of the comparative balance sheet and profit and loss statement and that the ratios should be interpreted in the light of other facts shown on these statements.

1. CURRENT RATIO.—This is the most commonly used and perhaps the most significant ratio for indicating financial condition. It shows the ratio or proportion of the current assets to current liabilities. The 1946 current ratio of the Modern Distributing Co. is determined by dividing its current assets by current liabilities.

$$\text{Example: } \frac{\text{current assets} \quad \$15{,}380}{\text{current liabilities} \quad \$6{,}000} = 2.56 \text{ current ratio.}$$

In computing this ratio, prepaid expenses should be omitted from the current assets even though they are shown under that heading. Prepaid expenses do not have as high "liquidity" in terms of cash as most other current assets.

As explained earlier, the current ratio provides information as to the amount of working capital, which is the excess of current assets over current liabilities. In the case above, working capital is the amount by which $15,380 exceeds $6,000, or $9,380. The amount of working capital reflects the ability of a business to finance its current operations after allowing for payment of its current liabilities.

It is commonly agreed that the current or "working capital" ratio for a store or a factory should ordinarily be at least 2. This means that the current assets should be at least twice the current liabilities, which provides $1 of "free" current assets for each dollar needed to cover the current liabilities. This 2 to 1 ratio is meant to be a safeguard to the business since a considerable part of current assets may consist of shop-worn or slow merchandise not yet sold and receivables which are not yet collected and subject to considerable discount for possible poor accounts.

It is obvious that a business which maintains current assets barely equal to its current liabilities will be in a weak financial condition if half or more of the current assets consist of merchandise and receivables. This would mean that in an emergency requiring payment of all current debt, the merchandise and receivables would need to be sacrificed or the business might find itself in the hands of its creditors. Either of these events would mean liquidation. Obviously, a current ratio of less than 2 may be satisfactory in some situations while a ratio higher than 2 should be maintained in situations where the current debt is of an extremely short term or demand character.

The following are the current ratios of the Modern Distributing Co. for its fiscal years 1941–46 inclusive:

1941	*1942*	*1943*	*1944*	*1945*	*1946*
4.2	3.9	3.4	3.6	3.0	2.56

While the ratio has declined during this period, it is still so favorable as to reflect a satisfactory current condition for this company.

2. Acid Test Ratio.—This ratio is similar to the current ratio, but shows cash capacity more sensitively. It expresses the relation between the "quick" assets, cash, collectible receivables, and readily salable securities, and the current liabilities. The 1946 ratio for the sample company is derived by dividing the quick assets by the current liabilities.

$$\text{Example: } \frac{\text{quick assets} \quad \$7{,}350}{\text{current liabilities} \quad \$6{,}000} = 1.2 \text{ acid test ratio.}$$

Inventories, prepaid expenses, and longer-term investments are excluded from current assets in computing the acid test ratio. When this ratio is 1, a business is considered in a satisfactory liquid condition. Such a ratio means that cash plus marketable securities and current receivables (items sometimes called quick assets) are equal to the current liabilities.

Acid test ratio for the sample company, 1941–46 inclusive, are:

1941	*1942*	*1943*	*1944*	*1945*	*1946*
1.5	1.6	1.4	1.4	1.3	1.2

The trend during the 6 years was downward, but the ratio in 1946 was still slightly above the standard. In fact, when the acid test ratio is as much as 2 to 1 or more, it may indicate that a company is carrying either too much cash or is allowing receivables to accumulate excessively. Unless there is a special reason for accumulating liquid funds, such as paying of maturing debts, it is well for management to examine the cash and receivables from the point of view of either investing some surplus cash in income securities or expanding its operations in order to put its liquid funds, including those tied up in its accounts and notes receivable, to work in the business.

3. Inventory to Current Assets.—This percentage ratio is obtained by dividing the inventory figure by the total current assets. For the sample company the ratio is expressed as:

$$\frac{\text{inventory} \quad \$8{,}000}{\text{current assets} \quad \$15{,}380} = 52 \text{ percent}$$

This percentage of inventory to current assets serves as an index to, and check upon, over-investment of current funds in inventory. As manager you may use this percentage ratio, along with the merchandise inventory turnover ratio, to determine a rational inventory policy in your business.

Inventory to current asset percentages for the company for the fiscal year 1941–46 are:

1941	*1942*	*1943*	*1944*	*1945*	*1946*
44%	41%	40%	42%	48%	52%

These percentages show the effects of the war years and a return to above normal levels in the last 2 years. As indicated by the trend of this percentage in 1945 and 1946, there is a danger that management might over-buy inventory on rising price levels.

4. LIABILITIES TO NET WORTH.—The purpose of this ratio is to reveal the relative proportions of business ownership belonging to all types of creditors on the one hand and to the proprietor on the other. It is calculated by dividing total liability by the net worth, thus:

$$\frac{\text{liabilities \$16,000}}{\text{net worth \$19,130}} = 83 \text{ percent}$$

When computed for several successive business periods, this ratio reveals the trend in proportion of debt to ownership, namely, whether a larger share of business assets is being held by the owner or whether business assets are being acquired through borrowing from creditors. In general, it is always preferable that business operations from year to year result in an increased proportion of ownership in the hands of the proprietor. This rule is subject to qualification, of couse, as a result of temporary or periodic borrowing on favorable terms to meet specific situations.

Ratios of liabilities to net worth are as follows:

1941	*1942*	*1943*	*1944*	*1945*	*1946*
20%	25%	40%	60%	70%	83%

The ratio of liabilities to net worth for the sample company indicates a regular decline in the stockholders' share of total ownership as shown by the rise in this ratio of total liabilities to the net worth. Whenever a business retires some or all of its debt, this debt to net worth ratio is reduced. When, however, a concern finds itself sufficiently established in its field, it may prefer to increase its debt financing for expansion purposes. In this case, the liabilities will again bulk larger in relation to net worth. This situation may be particularly desirable if equity capital is unavailable, surplus earnings are insufficient, and borrowing can be done at favorable interest rates, thus leaving a considerable portion of net earnings for stockholders.

5. SURPLUS TO NET WORTH.—This ratio is derived by dividing surplus and reserves by net worth.

$$\text{Example: } \frac{\text{surplus and reserves \$9,130}}{\text{net worth \$19,130}} = 48 \text{ percent.}$$

It indicates the extent to which net worth consists of permanent capital investment as shown by outstanding capital stock, and the extent it represents accumulated earnings set up in surplus account. As such, the ratio may reflect the amount of past earnings reinvested in the operations.

The ratio may be made up so as to include in surplus special reserves for emergencies and for replacement of depreciable assets. Since such reserves are a part of proprietorship, it is proper to include them in calculating this ratio. On the other hand, proprietorship values resulting from revaluation upward of fixed assets and of goodwill should not be included in the surplus item used in this ratio.

The following are surplus to net worth ratios for the sample company:

1941	1942	1943	1944	1945	1946
30%	35%	38%	40%	40%	48%

It is apparent that the company had during this period surplus ranging from one-third to almost one-half of the entire proprietorship. Such a figure provides a sizable cushion to absorb losses or adjustments without needing to draw upon the original capital investment.

6. NET WORTH TO NET FIXED ASSETS.—This ratio reflects the extent to which net worth (the owner's investment) is tied up in fixed assets (after deducting depreciation). It is derived thus:

$$\frac{\text{net worth}\quad \$19{,}200}{\text{fixed assets}\ \$18{,}000}=1.1$$

It indicates how much of the owner's equity is available as working capital after providing for fixed assets and the extent to which debt is used to provide working capital.

Ratios for the sample company are:

1941	1942	1943	1944	1945	1946
1.3	1.1	1.0	1.1	1.2	1.1

The object of the business manager should be to provide sufficient equity to more than cover the investment in plant and all types of fixed assets.

7. MERCHANDISE TURN-OVER.—This ratio has significance because of its usefulness in controlling inventories. The smaller the stock of merchandise a business can operate on and still meet all customers' demands, the smaller will be its requirements for working capital. This policy also reduces the storage space for merchandise and the expense for insuring goods in stock. This ratio, therefore, is designed to enable a business manager to measure his efficiency in purchasing, handling, and moving his stock in trade.

Merchandise turn-over is correctly computed when the cost of the goods sold during a fiscal period is divided by the average of the opening and closing inventories. This gives the number of times the average inventory has been "turned" during a period. For example, if the cost of goods were \$120,000 and the average of the initial and ending inventories were \$20,000, the merchandise inventory turn-over would be shown thus:

$$\frac{\text{cost of goods sold}\quad \$120{,}000}{\text{merchandise inventory}\ \$20{,}000}=6 \text{ times turned.}$$

The average age of the stock would be 2 months. This does not mean that every part of the stock has been sold and new stock purchased six separate times during the fiscal year, but that the equivalent of this has been accomplished in terms of the total goods handled during a 12-month period. It is obvious that some parts of inventory stocks may not have been turned at all, while others would have been turned at more than the rate of six times.

The rate of merchandise turn-over varies greatly with different types of businesses and with different degrees of management efficiency in terms of purchasing, inventory, and sales technique. A new business should keep a record of this ratio on its operations for each fiscal period, preferably 3 or 6 months, and should watch closely changes in the turn-over rate. By so doing, it can soon determine what the typical inventory turn-over rate is and whether it can be improved by careful management.

The turn-over rates for the sample company are:

1941	*1942*	*1943*	*1944*	*1945*	*1946*
2.6	3.0	3.9	3.8	4.0	4.26

In the ordinary merchandising concern, the inventory turn-over may be figured for all of the merchandise combined, or a separate rate of turn-over may be figured by departments or main types of merchandise. The latter is desirable because it enables management to spot slow-moving goods that should either be pushed more aggressively by sales technique or discontinued entirely. For this reason, every business manager engaged in distributing a variety of products should keep informed on the turn-over trends by figuring turn-over ratios for the main commodity groups.

In a manufacturing concern where inventories normally consist of raw materials, goods in process, and finished products, it is necessary for the turn-over rate to be calculated for each of these classes of goods if the ratio is to have any meaning for management.

8. Net Sales to Receivables.—A valuable index of customer accounts and collections is the ratio of net sales for a period to the amount of unpaid accounts and notes receivable at the end of that period. As our sample company had 1946 net sales of $49,200 and total receivables of $5,850, the ratio of sales to receivables is shown thus:

$$\frac{\text{net sales } \$49{,}200}{\text{receivables } \$5{,}850} = 8.4 \text{ times.}$$

This means that annual rate of sales is about eight times the amount of receivables on hand, or that the average period represented by unpaid accounts and notes receivable is one-eighth of a year's sales, or about 40 days' sales volume.

This ratio is most valuable in a concern which makes sales exclusively on credit. In companies which do a cash, as well as a credit business, this ratio of receivables should be calculated in relation only to the portion of the sales handled on credit.

Following are yearly ratios of sales to receivables for the sample company:

1941	*1942*	*1943*	*1944*	*1945*	*1946*
9.0	9.2	10.5	10.1	8.8	8.4

The figures indicate that receivables declined in relation to sales from 1941 to 1943 but that from 1944 to 1946 they expanded faster than sales. The significant fact is that since 1943 net sales have been a lower multiple of the receivables. It is in such situations of expanding receivables that the business manager should have before him either an annual or quarterly ratio on sales turn-over of receivables.

9. NET SALES TO NET WORTH.—This ratio indicates the number of dollars of sales during a fiscal period for each dollar invested by stockholders. For the sample company it is derived by dividing the net sales by the net worth.

$$\text{Example: } \frac{\text{net sales } \$49{,}200}{\text{net worth } \$19{,}130} = 2.5.$$

It is useful in measuring the economy of equity capital in relation to annual volume of business. It should be compared with the next ratio, namely, net profit as a percentage of net worth.

This company's ratios of net sales to net worth for the period of years are as follows:

1941	*1942*	*1943*	*1944*	*1945*	*1946*
2.8	2.1	1.8	1.8	2.4	2.5

The trend of this ratio shows the effects of the war years in reducing this company's volume of sales in relation to its net proprietorship and their recovery beginning with 1945.

10. NET PROFIT TO NET WORTH.—This ratio is considered along with the current ratio as one of the two or three most valuable measures of business operating efficiency. It is essential that any business being conducted for profit should keep informed on its profit trend. The most widely understood yardstick of profits is the percentage return on the proprietor's or stockholders' investment.

The ratio is obtained by dividing the net profit by the net worth.

$$\text{Example: } \frac{\text{net profit } \$4{,}810}{\text{net worth } \$19{,}130} = 25 \text{ percent.}$$

The ratios of net profit to net worth for the sample company for the 6-year period are as follows:

1941	*1942*	*1943*	*1944*	*1945*	*1946*
16%	16%	18%	19%	26%	25%

These figures, which in reality show the amount of net income in cents for each dollar of net worth, indicate a rising trend in the earnings of this company. This trend may be due to rising prices and margins, or it may be traced to more efficient operation through control of expenses and other managerial economies.

11. NET PROFIT TO TOTAL ASSETS.—This ratio is closely related to the previous one, net profit to net worth. While the previous ratio shows the profit per dollar invested by owners, this ratio gives the amount of profit per dollar of total investment in assets whether owned by proprietor or by creditors. Calculated by dividing net profit by total assets, it appears as follows:

$$\frac{\text{net profit } \$4{,}810}{\text{total assets } \$35{,}130} = 13.7 \text{ percent.}$$

It provides a reliable index of the efficiency of use of assets as a whole and may indicate the need for more assets. The ratios of the sample company are as follows:

1941	1942	1943	1944	1945	1946
6.5%	6.5%	8.0%	11.7%	15.1%	13.7%

Where the total liabilities of a business are nearly as large as the equity, as in this company, this ratio of net profit to total assets tends to be approximately one-half the rate of net profit to net worth.

12. Net Profit to Net Sales.—The ratio of net profit to net sales is one of the more significant ratios, showing the number of cents of profit for each dollar of sales. This percentage is shown on the comparative profit and loss statement and reflects the efficiency of operation in terms of expense control as well as efficiency in purchasing goods handled by the business. The ratio is figured by dividing the net profit by the net sales, thus:

$$\frac{\text{net profit } \$4{,}810}{\text{net sales } \$49{,}200} = 9.8 \text{ percent}$$

The ratios for the sample company are:

1941	1942	1943	1944	1945	1946
10.7%	10.6%	9.8%	10.5%	10.9%	9.8%

The variation in net profit per dollar of sales shown in these figures presents a situation requiring close study by management of all factors in the business. In such circumstances comparison of the operating statements for the last several operating periods affords a basis for detailed analysis of all factors contributing to profits.

IV. Comparison of Company's Ratios With Standardized Ratios

It is important for a business to make careful comparison of its financial statements and ratios for a current business period with the same statements and ratios of previous periods in order to determine trends, weak points, and needed improvements. Moreover, it is equally important to compare the company's statements and ratios with those of other businesses in the same line of activity and of approximately the same size. Although it is not usually possible to obtain the statements and ratios of other individual companies, it is frequently possible to get coded comparative data for a number of concerns through trade associations and similar organizations.

A necessary safeguard in making comparisons of this kind is that the businesses whose figures are used should have a standard or substantially uniform system of accounts; otherwise a comparison with an individual concern having different accounting forms would be entirely misleading. When a concern becomes well enough established to have membership in a trade organization, it usually will have no difficulty in finding sources of such comparative data for other business units in its field of activity.

Tables 6 and 7 contain excellent examples of comparative data, prepared by Dun & Bradstreet, that may be used to good advantage in determining an individual company's operating position in comparison with that of a large number of concerns.

For example, table 6 provides for each of 50 retail trades, ratios to net sales for such items as gross profits (margins), total operating expenses, and net profit or loss. In addition, ratios are shown for proprietors' wages, employees' wages, rent and advertising expenses. These 1939 ratios may be used as typical yardsticks for measuring operating efficiency in an individual business. Comprehensive data of similar kind for a more recent year are not now available. However, more up to date figures for certain trade lines may be had in a number of the Inquiry Reference Service leaflets of the United States Department of Commerce. Available copies of these leaflets, listed in the bibliography appended to this pamphlet, may be had gratis by request directed to the nearest field office of the Department. (See back cover for list of field offices of the U. S. Department of Commerce.

Equally valuable data for comparative purposes are presented in table 7. It shows for 50 retail trades, in cents per dollar of sales, the net profit, owners' salaries, and the total of these two returns to owners. Also, for each of the 50 trades, are given the typical 1939 sales volume and the typical dollar return to owners. Effective use may be made of these and similar figures by individual businesses in appraising their own operating results and charting future improvements.[1]

The preceding discussion of methods of analyzing business statements is meant to assist those who wish to apply such methods to their own businesses. The suggestions made do not cover all possible ways of interpreting business statements. Additional materials on the subject of financial and operating analysis are listed in the bibliography.

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[1] Businessmen who are interested in studying more recent and detailed figures on financial and operating ratios for specific trades and industries grouped into retailing, wholesaling, and manufacturing, are referred to Dun's Review, issues of October, November, and December 1947.

Table 6.—*TYPICAL OPERATING RATIOS OF 50 RETAIL TRADES, 1939*

Trade	Percentage of net sales								Inventory turn-over (times per year)
	Gross margin	Total operating expense	Net profit or loss	Proprietors' wages	Employees' wages	Rent or occupancy	Advertising	Bad-debt losses	
Foods, beverages, and restaurants:									
Alcoholic beverages	26.8	24.2	2.6	9.8	5.4	3.3	0.5	0.4	6.6
Bakery shops	54.0	48.0	6.0	11.0	20.9	6.1	.7	.2	13.8
Confectionery	34.1	29.3	4.8	12.0	6.6	6.6	.5	.3	10.8
Dairy and poultry products	39.2	35.5	3.7	8.6	12.1	3.4	.9	.6	35.9
Drinking places, taverns, and bars	35.9	31.9	4.0	10.8	9.0	5.9	.4	.7	15.8
Groceries	18.4	16.9	1.5	7.0	4.2	2.6	.6	.4	10.0
Groceries and meats	19.2	17.3	1.9	5.7	5.6	2.3	.6	.5	13.5
Groceries and filling stations	16.8	15.7	1.1	7.9	2.7	2.8	.3	.8	11.3
Meats	23.5	21.7	1.8	7.8	6.2	3.0	.4	.3	50.8
Restaurants and other eating places	43.3	39.2	4.1	8.3	16.3	6.8	.6	.4	25.9
General merchandise and farmers' supplies:									
Country general stores	17.9	15.4	2.5	6.2	4.2	2.2	.5	.8	3.9
Dry goods and general merchandise	28.1	25.1	3.0	8.2	6.7	3.9	1.1	.5	2.0
Farm implements	19.7	18.7	1.0	6.2	5.4	2.0	.4	.5	2.9
Farmers' supplies	17.5	15.0	2.5	4.2	4.3	1.9	.3	.5	8.7
Limited-price variety	31.5	26.5	5.0	9.4	7.2	5.1	.8	.2	2.8
Apparel:									
Custom tailors	63.2	61.9	1.3	17.3	26.8	8.0	1.6	.9	1.7
Family clothing (including children's shops)	30.6	27.3	3.3	8.4	6.9	4.7	1.3	.6	2.0
Furs	50.2	44.6	5.6	14.4	10.5	6.9	2.5	.6	2.0
Lingerie, hosiery, millinery, accessories	35.8	32.5	3.3	12.6	6.8	8.0	1.0	.2	2.8
Men's clothing	31.8	28.3	3.5	9.6	6.5	4.5	1.5	.6	1.8
Men's furnishings	34.2	33.2	1.0	11.3	6.4	8.3	1.2	.5	1.9
Shoes	32.9	30.7	2.2	10.4	7.3	6.0	2.0	.3	1.8
Women's ready-to-wear	30.5	28.7	1.8	9.2	7.0	5.3	1.2	.4	3.8
Automotive:									
Automotive accessories and parts	34.3	29.1	5.2	8.8	9.1	3.7	1.1	.8	3.0
Filling stations	24.3	22.3	2.0	8.8	5.8	4.3	.4	.5	15.9
Garages (with repairing)	48.9	46.8	2.1	14.9	15.9	6.8	.8	1.0	4.0
Motor vehicles	17.1	15.9	1.2	2.5	6.5	1.5	.6	.3	8.3
Furniture and household wares:									
Electric and gas household appliances	35.3	32.8	2.5	10.1	10.7	3.5	1.5	.5	4.6
Floor coverings	37.0	34.7	2.3	12.6	10.0	4.4	1.0	.5	3.1
Furniture	38.1	33.7	4.4	8.9	9.8	5.1	1.6	1.0	2.7
Furniture and undertaking	42.1	37.5	4.6	12.2	8.4	4.7	1.5	1.5	1.9
Housefurnishings	39.4	37.2	2.2	12.5	11.3	5.2	1.0	.7	2.8
Radios	44.5	42.1	2.4	19.8	10.0	5.1	2.4	.8	3.9
Building materials and hardware:									
Hardware	29.1	26.7	2.4	8.9	7.6	4.0	.9	.6	2.0
Paint, wallpaper, and glass	34.9	32.7	2.2	11.8	8.2	4.2	1.3	.8	2.6
Hardware and farm implements	20.4	20.6	-.2	6.5	6.2	2.3	.6	.5	2.4
Hardware and furniture	29.9	26.9	3.0	9.2	7.5	3.5	.9	1.0	1.9
Lumber and building materials	26.9	24.0	2.9	6.5	8.2	2.4	.5	.8	3.2
Other retailing:									
Books	35.4	34.8	.6	9.7	10.2	6.2	1.0	.1	2.3
Cigar stores and stands	23.9	21.6	2.3	9.2	4.8	5.6	.3	.3	8.0
Coal and other fuel	30.1	27.3	2.8	8.4	8.6	2.2	.6	.6	8.0
Drugs	30.5	28.1	2.4	9.6	7.8	4.8	.9	.3	3.1
Gifts, novelties, and souvenirs	42.3	36.0	6.3	15.4	6.1	9.7	.9	.5	1.8
Jewelry	48.9	43.6	5.3	17.0	10.4	6.4	2.1	1.0	1.1
Monuments	62.1	59.1	3.0	16.0	17.7	3.1	1.1	.9	1.3
Musical instruments	39.7	37.6	2.1	12.4	10.2	4.7	2.2	.4	3.0
Florists and nurseries	58.4	53.3	5.1	15.4	16.9	6.0	1.4	.6	3.7
Office equipment and supplies	40.4	37.4	3.0	10.4	13.3	4.0	1.2	[1]	3.2
Sporting goods	33.2	30.5	2.7	10.5		4.9	1.3	.4	3.1
Stationery	33.0	30.0	3.0	10.1	7.2	5.7	.9	.3	2.9
					7.9				

[1] Not available.

Source: Standard Ratios for Retailing, by Walter Mitchell, Jr., Dun & Bradstreet, Inc., 290 Broadway, New York.

Table 7.—*RETURNS TO OWNERS IN 50 RETAIL TRADES, 1939*

Trade	Typical 1939 percentages of—			Typical 1939 sales volume	Typical 1939 dollar return to owners
	Profit	Owners' salaries	Return to owners'		
Foods:					
Groceries	1.5	7.0	8.5	$21,300	$1,800
Groceries and meats	1.9	5.7	7.6	31,400	2,400
Groceries with filling stations	1.1	7.9	9.0	17,150	1,500
Dairy and poultry products	3.7	8.6	12.3	37,500	4,600
Meats	1.8	7.8	9.6	29,800	2,900
Confectionery	4.8	12.0	16.8	11,200	1,900
Bakery shops	6.0	11.0	17.0	29,900	5,100
General:					
Country general stores	2.5	6.2	8.7	19,550	1,700
Limited price variety	5.0	9.4	14.4	17,400	2,500
Dry goods, general merchandise	3.0	8.2	11.2	26,100	2,900
Apparel:					
Men's furnishings	1.0	11.3	12.3	20,900	2,600
Men's clothing	3.5	9.6	13.1	29,150	3,800
Family clothing (including children's shops)	3.8	8.4	11.7	27,800	3,300
Women's ready-to-wear	1.8	9.2	11.0	20,000	2,200
Furs	5.6	14.4	20.0	25,400	5,100
Lingerie, hosiery, millinery, accessories	3.3	12.6	15.9	8,600	1,400
Custom tailors	1.3	17.3	18.6	15,000	2,800
Shoes	2.2	10.4	12.6	22,000	2,800
Household:					
Furniture	4.4	8.9	13.3	37,700	5,000
Furniture and undertaking	4.6	12.2	16.8	25,200	4,200
Floor coverings	2.3	12.6	14.9	25,800	3,800
House furnishings	2.2	12 5	14 7	24,700	3,600
Electric, gas household appliances	2.5	10.1	12.6	24,400	3,100
Radios	2.4	19.8	22.2	8,600	1,900
Auto:					
Motor vehicles	1.2	2.5	3.7	136,500	5,100
Automotive accessories and parts	5.2	8.8	14.0	24,900	3,500
Garages (with repairing)	2.1	14.9	17.0	16,800	2,900
Filling stations	2.0	8.8	10.8	18,700	2,000
Lumber, hardware:					
Lumber and building materials	2.9	6.5	9.4	59,800	5,600
Paint, wallpaper, and glass	2.2	11.8	14.0	18,700	2,600
Hardware	2.4	8.9	11.3	24,300	2,700
Hardware and furniture	3.0	9.2	12.2	31,200	3,800
Hardware and farm implements	—.2	6.5	6.3	44,100	2,800
Farm implements	1.0	6.2	7.2	48,600	3,500
Other retail stores:					
Restraurants, other eating places	4.1	8.3	12.4	20,500	2,500
Drinking places, taverns, bars	4.0	10.8	14.8	17,700	2,600
Drugs	2.4	9.6	12.0	21,500	2,600
Alcoholic beverages	2.6	9.8	12.4	28,100	3,500
Coal and other fuel	2.8	8.4	11.2	33,000	3,700
Farmers' supplies	2.5	4.2	6.7	59,000	4,000
Jewelry	5.3	17.0	22.3	17,550	3,900
Books	.6	9.7	10.3	30,500	3,100
Stationery	3.0	10.1	13.1	25,200	3,300
Cigar stores and stands	2.3	9.2	11.5	15,000	1,700
Florists and nurseries	5.1	15.4	20.5	15,700	3,200
Gifts, novelties, and souvenirs	6.3	15.4	21.7	8,900	1,900
Musical instruments	2.1	12.4	14.5	19,650	2,800
Office equipment and supplies	3.0	10.4	13.4	165,000	22,100
Sporting goods	2.7	10.5	13.2	26,100	3,400
Monuments	3.0	16.0	19.0	16,300	3,100
Median (all trades)	*2.6*	*9.7*	*12.3*	*24,550*	*3,000*

In the first column of the table are shown *typical 1939 profit* percentages in 50 trades. The second column lists *owners' salary* percentages and the third column, *return to owners*, is the combined profit-and-owners'-salary rate obtained by adding the first two columns. When this rate of return to owners is applied to the *typical sales volume* figures shown in the fourth column, a dollar figure for *return to owners* can be derived which is roughly typical of operations in 1939 for stores of the size indicated * * *. The percentage figures are percentages of net sales.

All of the figures in this table, except the final column, have been taken from Dun & Bradstreet's *Standard Ratios for Retailing.* The year covered is 1939, and the stores in each sample are for the most part small ones, as indicated by the fourth column of the table. Current sales volume per store is considerably higher than 7 years ago, and estimates place present profit rates somewhat above those shown in the table.

Care should be exercised in using these figures. They serve to indicate certain general areas in which operating results in these fields may fall. They do not, however, gurantee that a newly opened bakery shop, for example, will return $5,100 to its owner the first year. In fact, the user is reminded that this typical figure is "typical" in that about half of the stores in this trade earned less than this amount.

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